Glenidan Consultancy Ltd.

To whom it may concern, July 31st, 2021

I am pleased to provide my thoughts regarding enhancing the mandate of the Canadian Public Accountability Board (CPAB) to improve the public's confidence in the accounting profession in general and the external auditor in particular. The CPAB has identified six areas under review in the Consultation Paper and I have responded to these matters below.

I would like to impress upon the CPAB the fundamental principle of transparency. Transparency trumps all other objectives when it comes to appropriate business behaviour. Without transparency then conflict of interest, fraud and material mistakes flourish. Transparency is the most effective means of establishing integrity and underpins, along with an independent judiciary, our democracy. When a society, an organization or an individual is not transparent then problems will arise.

As far as the remit of the CPAB is concerned I would like to see transparency regarding publishing the findings. I am an advocate of not only identifying the offending auditing firm but also the name of the lead partner on the engagement. The accounting profession - for example the Chartered Professional Accountants of Ontario - publishes disciplinary notices regarding members who do not act appropriately. By publishing the names of offending partners and firms then all parties, including the Audit Committee, are aware of the offenders. The Audit Committee can then monitor the performance of the auditing firm or replace them.

The most important issue facing the auditing profession is the damage caused to society when the auditor does not detect fraud. Some Canadian examples, amongst many, that have been reported in the business papers lately are Thrive Capital Management Ltd, Bridging Finance Inc., Quadriga Finteck Solutions, Paramount Equity Financial Corporation (Paramount) and Fortress Real Development Inc (Fortress). Canadian retail investors in these companies have suffered unrecoverable financial losses. Some well-know recent international examples include Wirecard AG & Parmalat S.p.A. The result of these frauds has led to an erosion of trust in the efficacy of the audit report. As Sir Donald Brydon noted, in a UK report titled Fraudulent Financial Reporting and the Role of Auditors, fraud is “the most complex and most misunderstood in relation to the auditor's duties”.

Why are the auditors not detecting fraud in a timely manner? As with anything that is complex there are many reasons for this. In order to evaluate the external auditor it is important to consider that:

(1) The external audit is focused on the financial statements. Many frauds perpetrated have a significant operational component which may not fall under the purview of the audit. Traditional auditing methodologies may not be designed to detect these transactions.

(2) The engagement letter between the external auditor and the client often states that the auditor is not responsible for detecting fraud; rather this is management's responsibility. Given that it is usually management perpetrating the fraud this has the perverse effect of absolving all parties from fraud prevention and detection.

(3) Collusion amongst fraudsters, although not as common as the single perpetrator fraud, makes fraud detection more difficult. Most internal controls in an organization are designed to prevent the single perpetrator fraud but do not address collusion.

(4) Corporations are becoming increasingly complex and external parties are at a disadvantage when trying to understand how transactions flow from origination to disclosure in the financial records. Various administration and accounting systems, with varying degrees of automation, are susceptible to deliberate or unintentional alteration.

(5) The whistleblower, who is responsible for detecting most frauds and is usually an employee within the offending organization, is often ostracized by management. Often the whistleblower must persist with their claims before they are taken seriously. Very rarely does the whistleblower contact the external auditor.

(6) When frauds are uncovered there are almost always conflict of interest issues with management. It is tempting, and often easy, for management to abuse their responsibilities especially if there is poor governance oversight. Conflict of interest, unless declared by the principals involved, can be difficult to detect.

(7) One industry-wide concern for the auditing profession is fee pressures from clients which results in reduced audit procedures. For example, most audits employ a substantive based audit that focuses on period end balances and ignores an understanding of the internal controls. Evidence suggests that substantive based audits have a low rate of fraud detection. In my opinion it is not appropriate that the external audit function does not confirm, for example, segregation of incompatible functions in order to prevent a fraud in the first place.

(8) Limited partner involvement during the audit. I have observed that the audit partner has limited involvement with the audit during the planning and execution phases of the audit; rather their attendance is limited to the final closing meetings. In my opinion this is too late in the process of understanding the client and how the audit staff addressed the financial statement risks. I understand that partners are expected to generate new business and this pressure may be affecting their availability to attend to existing clients.

(9) Inexperienced and poorly trained audit staff. This item is related to point 8 above. If the partner on the engagement is not providing on the job guidance then audit staff have to improvise. This contributes to inconsistent file documentation and inadequate audit procedures.

One matter that the CPAB has highlighted is that documentation in the audit files was deficient. In my opinion this is a serious problem for the profession. Apparently the auditor was relying too much on management and not seeking third party corroboration to support an independent assessment of the evidence.

If an auditor is not verifying the evidence then it is not possible to detect a fraud or financial statement errors. The raison dêtre of an audit is to seek third party, objective evidence to support management's assertions. This is the fundamental reason for an audit in the first place. Unless the auditor is fulfilling this objective there is no point in the audit. If an auditor does not understand how to perform a bank reconciliation, why attendance at an inventory count is important, how to identify source documents that support or refute management's reports then there are significant training and oversight processes that are lacking at the auditing firm.

I am of the opinion that there should be no half-measures when it comes to protecting society - the investor and consumer - from unscrupulous parties. The audit function is an important component of this objective and those, hopefully limited, examples of incompetence by reporting issuers uncovered by the CPAB should be put on public display.

I have reviewed the six areas under review in the Consultation Paper and I trust that, although I have not answered the questions in the order proposed, I have answered your questions.

Although the CPAB has not asked this question I am sure the reader will observe that I have highlighted a number of concerns with the auditing profession that are resulting in the findings highlighted by the CPAB. Until these underlying issues are addressed the CPAB will continue to identify failings which impede an effective audit. Any influence that the CPAB has on this broader issue would be welcome.

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